



November 10, 2005

To the Board of Supervisors  
Audit Committee  
County of San Bernardino, California

Ladies and Gentlemen:

We have audited the basic financial statements of the County of San Bernardino (the County) for the year ended June 30, 2005 and have issued our report thereon dated November 10, 2005. In planning and performing our audit of the basic financial statements of the County, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

During our audit we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized as follows:

#### **CURRENT YEAR MANAGEMENT LETTER COMMENTS**

##### **SOLID WASTE DIVISION - ACCOUNTS RECEIVABLE MANAGEMENT**

#### **OBSERVATION:**

During our test work over Solid Waste Division's (the Division) accounts receivable, the following observations were noted:

- As part of the closing process, the Division provides to the Auditor/Controller an account receivable aging report generated from the Solomon system. Prior to submitting the proposed accruals to the Auditor/Controller, Division staffs reconcile the aging report to each customer account and classify the receivable balances for financial statement presentation. During our accounts receivable test work, we noted the aging report submitted to the Auditor/Controller was generated on June 25, 2005. This was done to allow Division staff time to reconcile each customer account and meet established deadlines for submittal of year-end accruals. Although the aging report appropriately reflected the June 2005 billing, immaterial cash receipts collected from June 25 to June 30 were not posted to the aging report.
- The Division did not generate and review the accounts receivable aging report as of June 30, 2005. SWD staff indicated the Solomon system does not have the capability to go back to a specific date and generate a "historical" aging report. As such, the Division could not compare the June 25, 2005 aging report submitted to the Auditor/Controller to the June 30, 2005 aging report to ensure the completeness and accuracy of the aging report.

**CURRENT YEAR MANAGEMENT LETTER COMMENTS, Continued**

- The Division has an informal policy of holding cash receipts (checks) for customer accounts until the payment can be properly posted to the correct billing invoice. During our test work, we noted an amount of \$144,839 was not deposited in the County's bank account until two months after receipt from the customer. Consequently, the customer issued a stop payment on the check. As a result, the customer's account was not appropriately updated, thus overstating accounts receivable at June 30, 2005. It is also noted that \$522,171 in cash receipts were collected 5 days prior to June 30, 2005, but not deposited. This same amount was not reported to the Auditor/Controller as part of the year-end closing procedures. Audit adjustments were proposed and recorded to correct the June 30, 2005 accounts receivable and cash on hand balance.
- During our accounts receivable test work, we noted that both invoices and the offsetting credit memos were listed on the accounts receivable aging. In several cases, the Division has not consistently matched payments received against outstanding invoices. Additionally, it is noted that the Division has an informal policy of applying customer payments back to the same month the billing took place, irregardless of when payments are received. This above practice distorts the true aging of accounts receivable.
- During our test work, we noted that management review of bank reconciliations were not evidenced or documented.

**RECOMMENDATION:**

We recommend that the Division design procedures to ensure that proper cut-off for accounts receivable is achieved, cash received is deposited in a timely manner and that payments received and credit memos issued should be matched against appropriate invoices and differences investigated and reconciled on a timely basis.

**MANAGEMENT'S RESPONSE:**

Solid Waste Division Management agrees with the recommendation to design better procedures for handling accounts receivable. A portion of this problem is already being resolved with new ticket review and reporting procedures that will be implemented with the haulers. Management is committed to take a tougher stand regarding payment procedures with the haulers, cities and other account customers.

**UNTIMELY PREPARATION OF ELECTRONIC BENEFIT TRANSFER (EBT)  
ACCOUNT CASH RECONCILIATION**

**OBSERVATION:**

We noted that the Electronic Benefit Transfer (EBT) cash account from April 2005 through June 2005 had not been reconciled in a timely manner. Untimely reconciliation of cash accounts could cause any errors made by the bank or the County to go undetected in a timely manner.

## **CURRENT YEAR MANAGEMENT LETTER COMMENTS, Continued**

### **RECOMMENDATION:**

We recommend that the County put procedures in place to ensure that the EBT bank reconciliations are completed in a timely manner. In addition, these reconciliations should be reviewed by someone other than the preparer. By ensuring that these procedures are completed, the County will reduce the risk of cash being misappropriated and going undetected by management or their being errors on the financial statements.

### **MANAGEMENT'S RESPONSE:**

As of December 14, 2005 procedures were put into place to perform EBT bank reconciliations on a monthly basis. The reconciliation report is prepared by the EBT Fiscal Assistant and reviewed by the Administrative Supervisor. The reconciliation report is also attached to the request to fund the bank account and forward to the Auditor-Controller office for additional review.

## **DEBT MANAGEMENT**

### **OBSERVATION:**

It is noted the Auditor/Controller and CAO's office is charged with the responsibility of monitoring the County's outstanding long-term debt. This responsibility includes paying principal and interest when due, monitoring debt covenant compliance, monitoring arbitrage earnings, monitoring the related debt service schedules and reconciling trustee account activity. During our test work we noted the County did not reconcile the third party trustee account activity related to the 2004 Pension Obligation Bonds to the general ledger. As a result, material adjustments were required to the general ledger to properly reflect the activity in the trustee accounts.

### **RECOMMENDATION:**

We recommend that the County implement procedures to ensure the 2004 Pension Obligation Bond trustee accounts are properly reconciled in a timely manner.

### **MANAGEMENT'S RESPONSE:**

The Auditor/Controller-Recorder's (ACR) Office agrees with the recommendation and will implement procedures to ensure the timely reconciliation of the 2004 Pension Bond trustee accounts.

**CURRENT YEAR MANAGEMENT LETTER COMMENTS, Continued**

**MAINTENANCE OF HUMAN RESOURCE FILES**

**OBSERVATION**

During our testing of the Human Resource process, we noted several instances whereby employee's files did not contain original supporting records required as part of the audit process.

**RECOMMENDATION**

We recommend that the County design procedures to ensure that employee personnel files are kept current and support the status and pay rate of employees. By maintaining employee files current it will reduce the risk of errors and irregularities occurring in payroll and going undetected by management.

**MANAGEMENT'S RESPONSE:**

On Tuesday, November 1, 2005, the Board of Supervisors, through the mid year budget, authorized the funding for the Countywide Business Process Improvement Plan. Included in that plan was the request to fund a Personnel File Imaging System Countywide.

ISD is managing the project which will enable defined users to search for and view documents located in automated personnel files from a web based system. Key users will be defined and provided varying levels of security dependent on need.

Phase I of the project is underway. Estimated time for completion of this project is November 20, 2006. The Project Charter was completed September 30, 2005 and the Business Requirement was reviewed by HR on November 16, 2005. The status of this project is current and on time.

## **STATUS OF PRIOR YEAR MANAGEMENT LETTER COMMENTS**

### **UNTIMELY RECONCILIATION AND REVIEW OF WASTE SYSTEMS MONTHLY FAS 370 REPORTS TO BANK DEPOSITS**

#### **OBSERVATION:**

During our testing of internal controls over the cash management process, we noted that the Waste Systems department had not reconciled and reviewed the monthly FAS 370 report received from general accounting to copies of deposit slips submitted to the Treasurer in a timely manner from July 2003 through April 2004.

#### **RECOMMENDATION:**

We recommend that the County put procedures in place to ensure that Waste Systems follows established countywide policies and procedures over cash management. This includes the monthly review and reconciliation of the FAS 370 report to copies of deposit slips on a timely basis to ensure cash deposited was recorded by the bank and that general accounting has properly recorded these cash collections to the proper revenue accounts on the general ledger.

#### **STATUS:**

Implemented

## **MAINTENANCE OF HUMAN RESOURCE FILES**

#### **OBSERVATION:**

During our testing of the Human Resource process, we noted several instances whereby employee's files were incomplete or missing. It is noted the County implemented a digital archiving system in prior years to store employment records. Additionally, the County was utilizing a legacy digital archiving system during FY 1996-1999. However, we noted the system failed and data was lost as a result of the system failure. As a result, original supporting records required as part of the audit process could not be provided.

#### **RECOMMENDATION:**

We recommend that the County design procedures to ensure that employee personnel files exist and are kept current and support the status and pay rate of employees. By maintaining employee files current it will reduce the risk of errors and irregularities occurring in payroll and going undetected by management.

#### **STATUS:**

Not Implemented

**STATUS OF PRIOR YEAR MANAGEMENT LETTER COMMENTS, Continued**

**FREQUENCY OF ACTUARIAL REPORTS**

**OBSERVATION:**

Over the past fiscal years, the County has made over \$50 million dollars in adjustments to their self-insurance reserves. These adjustments have resulted from the ever-increasing costs and claims related to workers' compensation. Currently, the County has an actuarial study performed by an outside consultant every two years. The actuary provides the County with estimated loss reserve balances for the first and second year based on prior year claim data. As such, historical claim data is currently not considered for the period when no actuarial study is performed. During the "off-year" that an actuarial study has not been obtained, the County's Risk Management Division performs an internal analysis which historically has decreased the County's Risk Management related liabilities.

**RECOMMENDATION:**

Because of the volatility of the costs related to workers' compensation, we recommend that the County have an actuarial study performed on annual basis. By having this study performed annually, the most current claim data will be utilized by the actuary to project the needed reserves resulting in a more accurate accrual each year. In addition, this more frequent analysis will lend to the County being able to better assess their costs and charge the appropriate fees to each department on a timely basis.

At a minimum, the County should not adjust its risk management liabilities pertaining to "incurred but not reported" losses during the years where actuarial studies are not performed. This would result in a more conservative approach to recording these liabilities and prevent significant fluctuations in these liabilities between accounting periods.

**STATUS:**

Implemented

**STATUS OF PRIOR YEAR MANAGEMENT LETTER COMMENTS, Continued**

**FEDERAL AWARD REPORTING**

**OBSERVATION:**

During our examination of the County's procedures of compiling the Schedule of Expenditures of Federal Awards (SEFA) under the Office of Management and Budget (OMB) Circular A-133, it was noted that revenues are not consistently recorded between federal and state sources. In several circumstances, it was noted that federal revenue amounts were recorded within state revenue source object codes and visa versa. Although this practice does not misstate the County's revenues at the financial statement level, it does allow for the potential misstatement of expenditures under federal reporting requirements.

**RECOMMENDATION:**

We recommend that the County modify its procedures to classify current year revenues to be based on the proper allocation to either federal or state revenue source object codes. By implementing such a procedure, this would streamline the reporting process required under OMB Circular A-133 and provide additional control over the presentation of the SEFA.

**STATUS:**

Partially Implemented

**NEW GASB POUNOUNCEMENTS EFFECTIVE FOR FISCAL YEAR 2005-2006  
INFORMATIONAL ONLY**

In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This statement establishes accounting and financial reporting standards for impairment of capital assets and also clarifies and establishes accounting requirements for insurance recoveries. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2004.

In May 2004, the GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section – an amendment of NCGA Statement 1*. This statement establishes and modifies requirements related to the supplementary information presented in the statistical section that accompanies the basic financial statements. The provisions of this Statement are effective for statistical sections prepared for periods beginning after June 15, 2005. Implementation of this Statement will affect only the statistical section of the financial statements.

**STATUS OF PRIOR YEAR MANAGEMENT LETTER COMMENTS, Continued**

**NEW GASB PRONOUNCEMENTS EFFECTIVE FOR FISCAL YEAR 2005-2006  
INFORMATIONAL ONLY, Continued**

In December 2004, the GASB issued Statement No. 46, *Net Assets Restricted by Enabling Legislation—an amendment of GASB Statement No. 34*. This Statement clarifies that a legally enforceable enabling legislation restriction is one that a party external to a government—such as citizens, public interest groups, or the judiciary—can compel a government to honor. This Statement also specifies the accounting and financial reporting requirements if new enabling legislation replaces existing enabling legislation or if legal enforceability is reevaluated. Finally, this Statement requires governments to disclose the portion of total net assets that is restricted by enabling legislation. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2005.

In June 2005, the GASB issued Statement No. 47, *Accounting for Termination Benefits*. This Statement establishes accounting standards for termination benefits. This Statement supersedes accounting guidance in National Council on Governmental Accounting (NCGA) Interpretation 8, *Certain Pension Matters*, as amended, which addresses one form of voluntary termination benefits—*special termination benefits*, or those offered for a “short period of time.” It improves financial reporting by (a) adopting for *all* voluntary termination benefits recognition requirements similar to those in NCGA Interpretation 8, (b) establishing guidance applicable to involuntary termination benefits that requires governments, in financial statements prepared on the accrual basis of accounting, to account for the effects of termination benefits in the period in which the employer becomes obligated to provide benefits to terminated employees, and (c) elaborating on measurement issues associated with all forms of termination benefits. As a result of governments’ being recognized to account for similar termination benefits in the same manner, application of this Statement will enhance the comparability of financial statements.

The requirements of this Statement are effective in two parts. For termination benefits provided through an existing defined benefit OPEB plan, the provisions of this Statement should be implemented simultaneously with the requirements of Statement No. 45. For all other termination benefits, this Statement is effective for financial statements for periods beginning after June 15, 2005. Earlier application is encouraged.

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Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the County gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

This report is intended solely for the information and use of the Board of Supervisors, Audit Committee, management, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

*Vannik, Trine, Day & Co., LLP*

Rancho Cucamonga, California  
November 10, 2005